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# REFLECTIONS FROM PRACTICE

## A Transitioning State Experience: Shedding Communist Processes to Create an Investment-Friendly Czech Republic

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## Executive Summary

In 1993, as a newly independent country, the Czech Republic faced the challenge of attracting foreign investment and developing its economy. Despite the country's strategically supreme location at the heart of all the European markets, 41 years of communist rule left the Czech Republic desiring for the human resources, know-how and basic infrastructure required to attract foreign investors. Furthermore, power was centralized; to spur investment it was vital to have this leadership, some resistant, on board.

As Country Manager for the Czech Economic Development Certification Program, Michael Kunz and his colleagues sought to overcome the political and resource barriers to attract investment to the country. With funding from the Mellon Institute and support from George Mason University, Kunz and his colleagues conceived an economic development program. Their program - deemed an "entrepreneur strategy" - allowed them to institutionalize management systems for economic development activities at the local and national government level throughout the Czech Republic. Their strategy, instituted through a development certification program, promoted decentralization and enabled them to successfully certify and develop industrial parks in nine Czech Republic towns, establishing a cadre of 40 local and national economic development professionals.

The following reflection outlines the Czech Republic's business and political environment at the time, coloring the challenges of a transitioning country faced by Kunz and his colleagues. It then outlines the way in which Kunz and his colleagues worked with key players throughout the Czech Republic to position the country to increase inward FDI by a factor of four in less than 10 years.<sup>1</sup>

## Background: A Country in Transition

In late November of 1989, after a few weeks of large scale, non-violent protests, the Communist Party in Czechoslovakia relinquished control, ending 41 years of its uncontested rule. Four years later the Czech Republic and Slovakia peacefully dissolved from one into two separate states. At this moment, the new, reform-minded government of the Czech Republic (Czech) faced two monumental tasks: restructure the economy to foster private markets and transform authoritarian, centralized government systems into decentralized ones based on democratic principles. The Czech Government recognized that decentralization was essential to its economic and political transformation. It also recognized that its municipal governments lacked the managerial and technical capacity needed to meet their new responsibilities.

Against the ongoing backdrop of a country restructuring its economy – privatization, enterprise reform, and investment policy development - Czech national and local governments faced the challenge of setting the building blocks necessary to establish a democratic society. They aimed

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<sup>1</sup> Czech Invest Case Study: "Building a Competitive Product Package for Attracting FDI," p4



for openness and transparent government operations, participation of an informed citizenry, and accountability of public officials to their constituency. The country also strove to create a sustainable base for job creation and innovation in a competitive global market. Czech towns needed to play a key role in these areas, yet lacked the capacity to plan for the future and prioritize land and infrastructure development in a manner that promoted inward investment. Local government officials likewise did not have the experience to interpret community research and make informed decisions, attract private investment, and represent municipal interests at the national level.

While international companies wishing to gain a foothold in the emerging markets of Central and Eastern Europe regarded the Czech Republic in high esteem for its prize location and cheap labor, several barriers prevented their investment. Many of the investors requested:

- Zoned industrial land for sale, which was owned by local authorities
- Local economic data on the labor market, quality of life, cost and availability of utilities, land availability, land use controls and development costs, in order analyze investment feasibility
- Information about national and local regulations and procedures relating to investment in the Czech Republic

## Forcing Event: An Eye on Joining the EU

Adding to the tumult of the economic and political transition, by the mid-nineties the Czech Republic began discussing a possible accession into the European Union. This which came with strict requirements increased their impetus to decentralize and spur economic development. Lacking experience in a transition from a central economy to a market economy, the Czech government looked for help. Specifically the government needed a way to quickly devolve authority to the local level (i.e. local government and emerging private sector), though they were the very actors needed to assume authority, lacked knowledge of pluralistic government systems, the global economic system, and the rapidly emerging private sector.

Michael Kunz, Bern Ewert and their colleagues responded to the Czech Republic's need to build capacity at the national and local level that would ultimately enable local economic development. While numerous approaches existed, discussions with policy makers, local government officials, and firms, led Kunz and his colleagues to believe that organizing capacity building efforts around the attraction of foreign direct investment (FDI) would most effectively return authority to local municipalities.

Several factors pushed Kunz and Ewert to use the FDI approach. While the Czech Republic once ranked as the seventh most industrialized country in the world, 41 years under the Soviet System forced the country devoid of capital, leaving it in dire need of investment in key industries and new sectors like Information Communications Technologies (ICT).



Furthermore by emphasizing the development of local leaders and economies, Kunz and his colleagues responded to the emerging nature of the economy. Foreign firms sought to invest in the Czech Republic because of its local, human resource base, industrial tradition, and low labor costs. This presented an opportunity to set up successful models for policy and management systems affecting national government relations with local government and the private sector. Finally, FDI created jobs and increased the tax base. High unemployment levels and sagging government services plagued numerous cities throughout the Czech Republic. Organizing the local economic development around the attraction of investment provided a structured approach to facilitating the creation of jobs and the improvement of local services. This approach allowed the democratically elected mayor and city councils to demonstrate they were taking action to address constituent concerns.

## Response: Establishing a National-Local Economic Development Certification Program

As a means to assist the Czech Republic in its economic transition Michael Kunz and his colleagues with the support of Karel Dyba, the Minister of Economy and his advisor for economic policy, Zdenek Degen, developed a national/local economic development system based on the U.S. State of Virginia's Development Certification Program.

In order to meet the needs of the local and national governments, the Certification Program provided a methodological framework for implementing organizational change through the establishment of a national industrial development program, which promoted decision-making and responsibility in local governments. Relying on proven economic development models used in the United States and Western Europe, the program clearly described seven practical components needed to establish and maintain an effective economic development organization. The economic development components were implemented in the cities alongside robust training and technical assistance, designed to build local administrative and management capacity. The training and technical assistance aimed to transfer analysis and decision making skills to town hall leadership, enabling local leaders to achieve the economic development standards according to local conditions. Once the economic development operation was functional, local authorities established specific goals and objectives relevant to their economic and cultural environment. Under the Certification Program framework, these goals and objectives generally complimented the Czech Ministry of Economy's<sup>2</sup> coordinating role.

The program emphasized:

1. Attracting jobs and private investment to communities
2. Establishing the independence of municipalities by creating a local program that addresses the unique qualities, and challenges, of each community.

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<sup>2</sup> Later renamed the "Ministry for Regional Development"



3. Improving communication processes between municipalities and Czech ministries concerning economic development and other important national policies that affect local governments. Special emphasis was placed on creating a network of local government economic development agencies.
4. Developing business contacts with small and medium sized businesses in Virginia, the United States, and via the Czech Embassy in the United States.
5. Providing practical training and technical assistance in proven economic development techniques and procedures.

Because the Czech Republic faced competitors (i.e. Poland, Hungary) as it sought to attract jobs and inward investment, The Program focused on providing the right tools to the local governments that would attract investment inward. The Program helped local governments improve their competitive positions and enhance and expand their economic base. It did so by providing benchmarks against which communities could measure their degree of preparedness for economic growth.

George Mason University, a partner in The Program's design and implementation, provided training and technical assistance both in the US and the Czech Republic in the seven components required by The Program:

1. Management training to the Local Economic Development Organization
2. Community Information Requirements needed to highlight communities' strengths
3. Quality of Life Assessment to evaluate the community's strengths and weaknesses and develop a strategic plan for improvements in education, community services, recreation, culture and environmental quality
4. Local Contact Team to help market communities to prospective industrial investors
5. Financing Techniques to finance industrial development
6. Local Existing Industry Program to help local existing businesses expand in the community
7. Industrial Sites and Industrial Building Requirements to attract private investment.

## **Evaluation: Cities Certified, Investment Achieved and a Transferable Program**

After over a year of working with a variety of stakeholders from local governors to ministers, Kunz and his colleagues succeeded in developing an economic development certification process, which was coordinated at the highest level by the country's Ministry of Economy and Czech Invest, the national government's marketing agency for inward investment.



Czech cities meeting certain requirements<sup>3</sup> could apply to participate in the program. To achieve certified status, a city had 18 months to meet over 40 performance standards in the program's seven components.

By the time Kunz and his colleagues were drawing their involvement in the certification process to a close, nine cities had established/reorganized their economic development offices. While local governments had discretion over the type of office they developed, each of the nine used a standardized operational framework to attract investment, which served to create a common language and working culture for the country's economic development professionals. Each city designated a program coordinator to serve as the primary point of contact for the Ministry of Economy and Czech Invest.

All local office staff and government officials involved in the certification process learned to assess their community's internal and external strengths and weaknesses and develop programs to bolster weak areas.

In the end nine cities participated and received certification and 40 representatives received technical training. Local economic development offices began working with public and private sector to attract foreign direct investment. The local economic development office in the City of Plzen, a regional capital – whose Borska Pole high-tech industrial zone was begun in 1994 - succeeded in attracting a investment from such heavy hitters as Japanese television maker Matsushita, know in the U.S. as Panasonic, and businesses from California's Silicon Valley.

Kunz believes the grassroots, local government focus of the Program yielded its greatest strength, diffusing power, know-how and decision making ability. As such, he believes that iterations of the same program would enable countries in similar transitional states to achieve economic development; however, if he were to implement it again, he would add a more robust policy piece to allow for the experiences at the grass roots level to be effectively translated to national and local policy that removes obstacles to private sector development. Furthermore, he would involve legal experts at all stages of the program design and implementation to ensure that no unforeseen legal barriers prevented investment.

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<sup>3</sup> Requirements included: 1) Local Economic Development Organization/Department; 2. Economic surveys and marketing materials available for inward investors; 3. Strategic development plan and annual work plans for improvement (i.e. in education, work force development, services, environment, recreation, arts); 4. Local contact teams , comprised of private sector and government officials, in areas key to tracking investment, such as: finance (ex: local bankers, municipal finance director); business outreach; construction; economic research & marketing; local industry; community services; workforce; arts, culture and recreation. 5. Strategy and options for financing inward investment. This includes national and local law regarding financing as well as financial incentives (if any), private sector lending, and options for public private partnerships. 6. Local existing industry program 7. Industrial sites and buildings available for private sector investment. These had to meet certain technical criteria, particularly the industry parks.



## Conclusion: Recommendations for Economic Development Practitioners in Transitioning States

For future development practitioners aiming to do similar work in transitioning economies, Kunz recommends taking into consideration the potential impact on private sector development of internal and external incentives. The most significant external incentives were that of the European Union and the foreign investor. Following independence from the Soviet Union, Czech policy was to re-integrate into Europe as a member of the European Union. The European Union integration policies provided incentives for the Czech Republic to establish policies and implement programs like the Czech Certification program that allowed the newly independent nation to meet EU pre-accession criteria. Practitioners and policy makers should consider the capacity and incentive structures of the State, as well as the regional political and economic unions where they operate, to promote private sector development.

Kunz recommends talking to the private sector –potential local and foreign investors – to understand their needs. This will enable local communities and on a broader scale, countries, to position themselves (i.e. through incentive structures, understanding of strengths) to attract a solid group of investors. He also recommends involving legal experts in addition to policy experts and government officials from the beginning, to ensure that all actors have a comprehensive – political, economic, and legal - understanding of the investment environment.

Finally, Kunz advocates for positioning local communities to accept investment in a way that organizes communities and enables them to achieve overall development goals (i.e. education, workforce training, etc). Once a foreign investor enters a community, that community should be ready to take advantage of the extra tax revenues and potential for workforce development. Putting energy into attracting foreign direct investment does not mean that other development goals are forgotten. Rather, these efforts can be organized in a manner that helps ensure that other development goals, such as health and education, are met through the organization of local resources and the generation of additional revenues resulting from inward investment.